

Message Text

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ACTION EB-04

INFO OCT-01 SS-14 ISO-00 EUR-08 TRSE-00 OMB-01 CIAE-00
INR-05 NSC-05 DODE-00 PM-03 SP-02 ACDA-10 L-01
DOE-01 SOE-01 IO-06 DOEE-00 SSO-00 H-01 /063 W
-----106942 121420Z /44

P R 121240Z JUL 78
FM AMEMBASSY ANKARA
TO SECSTATE WASHDC PRIORITY 2600
INFO AMCONSUL ADANA
AMCONSUL ISTANBUL
AMCONSUL IZMIR
AMEMBASSY JIDDA
AMEMBASSY KUWAIT

C O N F I D E N T I A L SECTION 1 OF 2 ANKARA 5114

LIMDIS

E.O. 11652 XGDS-1
TAGS: EFIN, IMF, TU
SUBJ: TURKEY'S IMF STANDBY PERFORMANCE

REF: ANKARA 4003

SUMMARY: TURKEY IS DANGEROUSLY CLOSE TO VIOLATING A NUMBER OF PERFORMANCE CRITERIA IN ITS IMF STANDBY AGREEMENT. A FUND TEAM, HEADED BY CHARLES WOODWARD, IS CURRENTLY IN ANKARA ATTEMPTING TO FOCUS THE ATTENTION OF THE TURKISH AUTHORITIES ON THE NEED FOR IMMEDIATE CORRECTIVE ACTIONS. TURKEY'S FAILURE TO MEET ITS IMF STANDBY CONDITIONS WOULD LIMIT THE AVAILABILITY OF PRIVATE FOREIGN CREDITS TO TURKEY AND COULD JEOPARDIZE THE RESCHEDULING OF \$2.5 BILLION DUE TO FOREIGN BANKS. IN THIS EVENT, WE COULD EXPECT THE TURKS TO LOOK FOR A SCAPEGOAT TO BLAME FOR THEIR FAILURE TO MAKE ECONOMIC PROGRESS. THEY WOULD BE LIKELY TO PICK THE UNITED STATES FOR THIS ROLE, EXPECIALLY IF CONGRESS SHOULD DECIDE NOT TO
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REPEAL THE MILITARY SALES EMBARGO AGAINST TURKEY. END SUMMARY

1. TURKEY HAD IMPLEMENTED ITS STABILIZATION PROGRAM INADEQUATELY AND IS IN DANGER OF FAILING TO COMPLY WITH A NUMBER OF PERFORMANCE CRITERIA NECESSARY TO QUALIFY FOR FURTHER DRAWINGS UNDER ITS IMF STANDBY AGREEMENT. CHARLES WOODWARD, LEADER OF THE IMF TEAM CURRENTLY PERFORMING THE

FIRST QUARTERLY REVIEW OF TURKEY'S STANDBY PERFORMANCE, EXPRESSED HIS DEEP CONCERN AND DISAPPOINTMENT THAT THE ECEVIT GOVERNMENT HAD FAILED TO TAKE ADVANTAGE OF ITS FIRST MONTHS IN OFFICE TO MAKE THE DIFFICULT POLITICAL DECISIONS NEEDED TO "TURN AROUND" THE TURKISH ECONOMY. WOODWARD MET PRIVATELY WITH EMBOFFS AT HIS INITIATIVE, EVENING OF JULY 10, AND ENGAGED IN WIDE-RANGING DISCUSSION OF TURKEY'S ECONOMIC POLICIES, PROSPECTS AND OPTIONS, ELICITING OUR IMPRESSIONS OF EVENTS AND PERSONALITIES. THE FOLLOWING WERE AMONG THE SIGNIFICANT POINTS COVERED:

2. STANDBY PERFORMANCE: WOODWARD EXPLAINED THAT TURKEY WAS IN DANGER OF VIOLATING SEVERAL CONDITIONS PREREQUISITE TO QUALIFY FOR FURTHER DRAWINGS UNDER THE STANDBY AGREEMENT. TURKEY HAD ALLOWED NEW ARREARS (FROM \$50 TO \$100 MILLION) TO ACCUMULATE ON CURRENT TRANSACTIONS DURING MAY, HAD SIGNED TRADE AGREEMENTS WITH FUND MEMBERS WHICH MIGHT BE CHARACTERIZED AS BILATERAL PAYMENTS AGREEMENTS, AND WAS CLOSE TO BREECHING THE CEILINGS ESTABLISHED ON CENTRAL BANK NET DOMESTIC ASSETS AND NET CREDITS TO PUBLIC SECTOR. WOODWARD EMPHASIZED THAT NEITHER HE NOR THE IMF STAFF HAD DETERMINED, OFFICIALLY, THAT ANY OF THE STANDBY CONDITIONS HAD BEEN BROKEN, BUT THAT THE PURPOSE OF HIS VISIT AT THIS TIME WAS TO BRING THESE PROBLEMS TO TURKEY'S ATTENTION IN THE HOPE THAT CORRECTIVE ACTION MIGHT BE TAKEN IN TIME TO AVOID A SITUATION IN WHICH TURKEY IS JUDGED NOT TO BE IN COMPLIANCE WITH TERMS OF STANDBY AND CONFIDENTIAL

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INELIGIBLE FOR SUBSEQUENT CREDIT TRANCHE DRAWINGS.

3. ON HIS PREVIOUS VISIT, MAY 23-24 (SEE REFTTEL), WOODWARD HAD RECOMMENDED SEVERAL CORRECTIVE MEASURES TO THE TURKS. THESE INCLUDED INCREASING REBATES FOR MANUFACTURED EXPORTS (ENACTED JULY 6), HIGHER COAL PRICES (ENACTED JUNE 17), A RISE IN ELECTRICITY RATES (ENACTED JULY 7), AND AN INCREASE IN PETROLEUM PRODUCT PRICES (NOT YET ENACTED BUT WOODWARD EXPECTS THIS TO OCCUR SOON). WOODWARD AND HIS STAFF HAVE NOT YET DETERMINED WHETHER THE IMPLEMENTATION OF THESE MEASURES IS SUFFICIENT TO OVERCOME TURKEY'S IMMEDIATE PROBLEMS. HOWEVER, ONE KEY SHORTCOMING IS THAT TURKS HAVE BEEN RELUCTANT TO ESTABLISH A MORE FLEXIBLE EXCHANGE RATE POLICY, SOMETHING WOODWARD CONSIDERS ESSENTIAL TO THE SUCCESSFUL IMPLEMENTATION OF TURKEY'S STABILIZATION PROGRAM.

4. SHORT-TERM OUTLOOK: WOODWARD SAID THAT NOBODY WOULD BENEFIT IF THE IMF ADOPTED A STRICT LEGALISTIC INTERPRETATION OF TURKEY'S COMPLIANCE SHORTCOMINGS AND FLATLY CUT THEM OFF FROM FURTHER TRANCHE DRAWINGS. HE HELD OUT THE PROSPECT THAT WITH ADDITIONAL EFFORT BY THE TURKS IN DEALING WITH THEIR PROBLEMS, THE IMF COULD PROBABLY WORK OUT SOME KIND OF

ARRANGEMENT WHICH WOULD PERMIT THE NEXT TRANCHE DRAWING OF SDR 40 MILLION AFTER AUGUST 25. BUT, HE SAID, THE BALL WAS NOW IN THE TURKS' COURT AND THEY WOULD HAVE TO COME UP WITH A PLAN TO IMPROVE IMPLEMENTATION OF THEIR STABILIZATION PROGRAM.

5. THE SHORT-RUN CONSEQUENCES OF TURKEY'S FAILURE TO MEND ITS TATTERED IMF STANDBY ARE PLAIN TO SEE. IN ADDITION TO LOSING ACCESS TO IMF FUNDS, TURKEY WOULD ALSO SCUTTLE THE \$2.5 BILLION RESCHEDULING OF CONVERTIBLE LIRA DEPOSITS AND OVERDUE BANKERS' CREDITS AND FORECLOSE THE POSSIBILITY OF A EUROCURRENCY LOAN SYNDICATION FROM COMMERCIAL BANKS. (SEE

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-----106743 121421Z /44

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FM AMEMBASSY ANKARA
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SEPTTEL FOR DETAILS). SUCH A SITUATION WOULD AGGRAVATE TURKEY'S ALREADY DESPERATE FOREIGN EXCHANGE POSITION, FORCE FURTHER CURTAILMENT OF IMPORTS AND PROBABLY THROW THE ECONOMY INTO A RECESSION.

6. WOODWARD WAS QUITE AWARE SUCH A SCENARIO COULD HAVE SIGNIFICANT POLITICAL CONSEQUENCES AND HE SOUNDED OUT EMBOFFS' OPINIONS REGARDING COMPETENCE OF KEY MINISTERS (MUEZZINOGLU, BULUTOGLU, KOPRULULER, CETIN AND BAYKAL), THEIR POLITICAL STRENGTHS AND WEAKNESSES, AND THE GENERAL

POLITICAL STABILITY OF THE ECEVIT GOVERNMENT. WOODWARD COMMENTED THAT HE WOULD HAVE TO BE EXTREMELY DIPLOMATIC IN HIS NEGOTIATIONS WITH THE TURKS SINCE HE COULD NOT SPELL OUT POLICY PRESCRIPTIONS BUT HAD TO RELY ON THE TURKS TO FIND THEIR OWN REMEDIES TO THE PROBLEM. HE SAID THAT THE NEW IMF MANAGING DIRECTOR HAD ADVISED HIM TO BE CAREFUL IN HANDLING TURKEY'S STANDBY PROBLEMS, BUT, HE CONFESSED, HE WAS AT A LOSS

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TO DETERMINE EXACTLY WHAT "BEING CAREFUL" MEANT IN THIS SITUATION.

7. LONGER-TERM OUTLOOK: WOODWARD WAS EVEN MORE PESSIMISTIC ABOUT LONGER TERM PROSPECTS FOR THE TURKISH ECONOMY. HE COMMENTED THAT TURKEY'S IMPORT ELASTICITY WAS QUITE HIGH, AND GIVEN THE POLICY COMMITMENT OF THE ECEVIT GOVERNMENT TO ANNUAL AVERAGE GROWTH RATES IN EXCESS OF 8 PERCENT OVER THE NEXT FIVE YEARS, THIS IMPLIED AN ANNUAL INCREASE IN IMPORTS OF 10 TO 12 PERCENT IN VOLUME TERMS AND 16-18 PERCENT IN VALUE TERMS. TO FINANCE THIS INCREASE IN IMPORTS IN ADDITION TO THE REPAYMENT OF DEBTS CURRENTLY BEING DEFERRED UNTIL 1981 WILL CREATE AN UNMANAGEABLE BURDEN ON THE ECONOMY IN THAT YEAR. TURKISH POLICY MAKERS, HE THOUGHT, HAVE YET TO COME TO GRIPS WITH THE FACT THAT TURKEY CANNOT GENERATE OR BORROW THE RESOURCES NECESSARY FOR RAPID GROWTH AND REMAIN AN OPEN, MARKET ECONOMY. THE ALTERNATIVE WHICH MAY APPEAL TO THESE POLICY MAKERS IS TO OPT FOR A CLOSED ECONOMY WITH CLOSER TIES TO EASTERN BLOC COUNTRIES.

8. IMPLICATIONS FOR THE U.S.: IN EMBASSY'S VIEW, THE FAILURE OF THE IMF STANDBY FOLLOWED BY THE WITHHOLDING OF COMMERCIAL BANK FUNDS AND THE LACK OF SIGNIFICANT OECD CONSORTIUM ASSISTANCE WOULD PROBABLY SEND THE TURKS IN HOT PURSUIT OF A SCAPEGOAT. MANY WOULD BE READY TO BELIEVE THAT THEIR COUNTRY WAS BEING STRANGLERED BY A U.S.-LED ECONOMIC EMBARGO. THIS WOULD PARTICULARLY BE TRUE IF CONGRESS SHOULD FAIL TO LIFT THE EMBARGO ON MILITARY SALES TO TURKEY. DILLON

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCIAL STABILITY, FINANCIAL AGREEMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 12 jul 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978ANKARA05114
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: X1
Errors: N/A
Expiration:
Film Number: D780285-0657
Format: TEL
From: ANKARA
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780771/aaaachyf.tel
Line Count: 211
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 26784977-c288-dd11-92da-001cc4696bcc
Office: ACTION EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: 78 ANKARA 4003
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 13 jun 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2044366
Secure: OPEN
Status: NATIVE
Subject: TURKEY'S IMF STANDBY PERFORMANCE
TAGS: EFIN, TU, IMF
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/26784977-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014